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In the Supreme Court of the United States

OCTOBER TERM, 1978

BENJ. FRANKLIN FEDERAL SAVINGS & LOAN ASSOCIATION, PETITIONER

v.

DERENCO, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF OREGON

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

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ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF OREGON

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

This memorandum is filed in response to the Court's invitation of October 2, 1978.

1. In 1932 Congress enacted the Federal Home Loan Bank Act (12 U.S.C. 1421 *et seq.*) for the express purpose of making available to the public a reserve of capital for home financing. In 1933, as home financing continued to be affected by the Depression, Congress passed the Home Owners' Loan Act of 1933 ("HOLA"), 12 U.S.C. 1461 *et seq.* HOLA created the federal savings and loan system and conferred on the Federal Home Loan Bank Board, created by the 1932 Act, the authority to prescribe regulations "to provide for the organization, incorporation, examination, operation, and regulation of association's to be known as 'Federal Savings and Loan Association', and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." 12 U.S.C. 1464(a).

The Board has promulgated detailed regulations governing practically every phase of the activities of federal savings and loan assocations, including lending practices and the payment of interest on accounts. 12 C.F.R. Part 541 *et seq.* At all material times in this litigation, these regulations authorized associations to collect monthly insurance and tax installments from borrowers as security for payment of taxes and insurance premiums on real estate security for loans. A recent amendment to the regulations requires, for loans made since June 16, 1975, that interest on such reserves be paid to borrowers where state statutes require state-chartered savings and loan associations, mutual savings bank and similar institutions to pay such interest to borrowers; otherwise, associations are not required to pay such interest but are permitted to agree to do so in their loan agreements. 12 C.F.R. 545.6-11(c).[1]

In the decision now challenged, the Supreme Court of Oregon concluded that for loans made prior to June 16, 1975, the regulations were silent on the issue whether associations were required to pay interest on such

[1]12 C.F.R. 545.6-11(c) provides:

> (c) *Payment of interest on escrow accounts.* A Federal association which makes a loan on or after June 16, 1975 on the security of a single-family dwelling occupied or to be occupied by the borrower (except such a loan for which a bona fide commitment was made before that date) shall pay interest on any escrow account maintained in connection with such a loan (1) if there is in effect a specific statutory provision or provisions of the State in which such dwelling is located by or under which State-chartered savings and loan associations, mutual savings banks and similar institutions are generally required to pay interest on such escrow accounts, and (2) at not less than the rate required to be paid by such State-chartered institutions but not to exceed the rate being paid by the Federal association in its regular accounts (as defined in §526.1 of this chapter). Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph.

accounts. The court held that the "gap" in the regulations could be filled by state law and, accordingly, applied Oregon's doctrine of unjust enrichment to require petitioner to pay interest at the pass-book rate on all such reserve accounts on certain loans made prior to the amendment of the regulations. The court rejected petitioner's contention that the Board's regulations so occupied the field that no state law could be applied to regulate associations' lending practices (Pet. App. 43).

The court also held that no recovery would be allowed under loan agreements used by petitioner after February 1, 1972, because those agreements specifically provided that no interest would be paid to borrowers on such reserve accounts (Pet. App. 58-59). The court further excluded from its holding any mortgages sold to the Federal Home Loan Mortgage Corporation (Pet. App. 26 n.2). In sum, the decision below affects only certain loans made by the petitioner prior to February 1, 1972.[2] Loans made thereafter are not affected by the decision.

2. We submit that the decision here is incorrect to the extent that it requires petitioner to make interest payments. The decision is based on the assumption that until 1975 there was a "gap" in the Board's regulations concerning the duty of associations to pay interest on accounts established for the payment of taxes and insurance premiums on mortgage loans prior to June 16, 1975. In fact, for loans prior to that date the regulations permitted associations to decide for themselves whether to pay such interest.

Associations are required by the Board to provide in their loan agreements specifically for full protection of the

[2]Loans made before July 1968 are unaffected by the decision because of the effect of the state's statute of limitations (Pet. App. 25).

security with respect to insurance and taxes, 12 C.F.R. 545.6-11(a). Associations may require that homeowner-borrowers make monthly installments into accounts "established in connection with such loan for the purpose of assuring payment of taxes, assessments, insurance premiums and other charges with respect to the property * * *" 12 C.F.R. 545.6-11(b). Such accounts fall within the definition of a "short-term savings account," which is (12 C.F.R. 541.5):

> [A] savings account in a Federal association established for the purpose of accumulating funds to pay taxes or insurance premiums, or both, in connection with a loan on the security of a lien on real estate.

Although regulations require associations to distribute earnings on almost every other type of savings account, they do not require distribution of earnings on "short-term saving accounts." Federal charters establishing federal associations are subject to the terms set forth in 12 C.F.R. 544.1.[3] These provisions, after requiring mandatory distribution to other accounts, state (12 C.F.R. 544-1):

> *Provided,* That the association is not required to distribute earnings on short-term savings accounts * * *.

These regulations have been in effect since at least 1958.

The proviso that associations are not required to pay interest on short-term savings accounts is more than a mere explanation that the federal mandatory distribution requirements do not comprehend short-term savings accounts. It authorizes federal associations to decide for themselves whether interest should be paid on short-term

[3]The Board's records show that since 1954 petitioner has operated under a charter in the form of Charter K (rev.), which includes the provisions of 12 C.F.R. 544.1.

savings accounts. Having authorized associations to accept a series of different savings accounts (including short term savings accounts), and having required interest to be paid on all other accounts, the express statement in the same breath that associations are "not required" to pay interest on short-term accounts creates a federal rule that associations may elect whether to pay such interest.[4]

Precisely this construction was placed on the regulations when the General Counsel of the Board issued an opinion in 1970 concluding that federally chartered associations were authorized "to pay or not to pay interest on escrowed funds," because they were short-terms savings accounts. Fed. Home Loan Bank Board, *Annotated Manual of Statutes and Regulations* para. 715 (3d ed. 1977). Any doubt about the Board's intent was eliminated in a 1971 amendment that restates the same point affirmatively:

> A federal association which has a charter in the form of charter N or charter K (rev.) *may*, after adoption by its board of directors of a resolution so

[4]As the Court recognized last Term, " 'where failure of * * * federal officials affirmatively to exercise their full authority takes on the character of a ruling that no such regulation is appropriate or approved, ' States are not permitted to use their police power to enact such legislation." *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151 178 (1978). In *Ray* this Court held that the failure of the Secretary of Transportation to limit the size of tankers in Puget Sound, except for certain size limits in Rosario Strait, amounted to a determination that no other size limitation should be imposed for Puget Sound. Therefore, Washington's statute excluding supertankers of certain sizes from Puget Sound was held to be in conflict with the Secretary's action. Likewise, in the present case, the Board promulgated detailed regulations governing the distribution of earnings to accounts and established mandatory requirements for interest distributions on almost all accounts. When it came to the accounts in question, the Board acted not merely by silence, as the Secretary did in *Ray*, but by specifically providing that associations were "not required" to distribute earnings on such accounts.

providing and while such resolution remains in effect, distribute earnings on any designated class or classes of short-term savings accounts* * *. [12 C.F.R. 545.1-1(g) (emphasis added).]

The authority of federal associations to decide for themselves whether to pay interest on the accounts in question was not intended to be subservient to state law. The system of Board regulations is based on the assumption that federal permission for associations to engage in certain practices entirely displaces state law on the subject, except where the regulation specifically provides otherwise. The regulations demonstrate this in two ways.

First, the Board's regulations expressly identify the instances where state law will control or limit an association's discretion. One example is the amendment deferring to state law on the question of interest on reserve accounts for certain loans after June 16, 1975. 12 C.F.R. 545.6-11(c). Second, throughout the regulations, the Board has frequently given its permission to associations to engage in many lending practices with the obvious, if unexpressed, intention of displacing any restrictive state law to the contrary. For example, associations are permitted but not required to sell certificates of deposit, 12 C.F.R. 545.1-5; in certain specified states, to allow withdrawals from accounts in the form of negotiable instruments payable to third parties, 12 C.F.R. 545.4-1(a)(3); to participate in certain loans with approved banks, 12 C.F.R. 545.6-4; to require borrowers to pay settlement costs, 12 C.F.R. 545.6-10; and to include due on sale clauses in loan agreements, 12 C.F.R. 545.6-11(f). The Board has chosen in such areas to permit but not require certain practices. The Board's conscious decision to leave certain matters up to the association's business judgment was plainly not intended to be nullified by state regulation. If the Board had intended to leave certain permissive matters up to state law, it would

have said so rather than directly addressing the matter with express, if permissive, regulations. In sum, the fact that the Board expressly stated that associations may collect advance tax and insurance installments without paying interest can only be understood as an intent by the Board to deny to the states the power to compel payment of such interest.

Thus, at all material times in this litigation prior to June 16, 1975, the Board authorized petitioner to require borrowers to make advance installment payments for taxes and insurance on real estate security without any obligation of paying interest. This federal regulation must prevail over the contrary state law. *Free* v. *Bland,* 369 U.S. 663, 667-668 (1962). Because the court below did not consider the significance of 12 C.F.R. 541.5, 544.1 and 545.1-1(g) in reaching its decision, it may be appropriate for this Court to grant the petition for a writ of certiorari, vacate the judgment, and remand for further consideration. See *Massachusetts* v. *Westcott,* 431 U.S. 322 (1977).[5]

3. If the Court concludes that a remand for this limited purpose is inappropriate, however, then it should deny the petition. Although the holding of the Supreme Court of

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[5]This Court has jurisdiction to order such a remand even though the parties did not bring 12 C.F.R. 541.5, 544.1, and 545.1-1(g) to the attention of the Supreme Court of Oregon. It followed the course of remanding in *Westcott* despite a similar failure by the parties. Cf. *Lear, Inc.* v. *Adkins,* 395 U.S. 653, 662 n.10 (1969). The parties raised and fully litigated the preemption issue in the state courts, and the fact that they overlooked a particular regulation bearing on that issue does not defeat this Court's jurisdiction.

The finality requirement of 28 U.S.C. 1257(3) is met because the accounting that remains to be done in the trial court (Pet. App. 75) could not give rise to a federal question, and nothing that could happen in the course of the remand, short of settlement of the case, would foreclose or make unnessary decision of the federal question. *Radio Station WOW, Inc* v. *Johnson,* 326 U.S. 120, 127 (1945); *Cox Broadcasting Corp.* v. *Cohn,* 420 U.S. 469, 480 (1975).

Oregon that the Board's regulations do not "occupy the field" so as to preempt even harmonious state regulation conflicts with many other decisions on that question,[6] the

[6]With respect to concurrent state regulations not conflicting with the Board's regulations, most courts have held that the Board's regulations "occupy the field" and that even harmonious state regulation may not be applied to federal associations. *E.g., Murphy* v. *Colonial Fed. Sav. & Loan Ass'n*, 388 F. 2d 609, 611 (2d Cir. 1967) (right of dissident members to membership list, though not clear under Board regulations, should be determined by federal law); *Greenwald* v. *First Fed. Sav. & Loan Ass'n of Boston*, 446 F. Supp. 620, 623-624 (D. Mass. 1978) (Massachusetts statute requiring interest to be paid on tax and insurance escrows invalid before and after promulgation of 12 C.F.R. 545.6-11(c)); *California* v. *Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311, 316, 318-320 (S.D. Cal. 1951) (state laws regulating banks may not be applied to activities of association allegedly held out to the public as banking functions); *Rettig* v. *Arlington Hgts. Fed. Sav. & Loan Ass'n*, 405 F. Supp 819-826 (N.D. Ill. 1975) (authority of associations to sell insurance through subsidiary corporations and obligations of directors regarding corporate opportunities); *City Fed. Sav. & Loan Ass'n* v. *Crowley*, 393 F. Supp. 644, 655 (E.D. Wisc. 1975) (in view of occupation of field by Board's regulations, gaps in regulations must be resolved by federal common law); *Kaski* v. *First Fed. Sav. & Loan Ass'n of Madison*, 72 Wisc. 2d 132, 240 N.W. 2d 367 (1976) (state law inapplicable to leading practices of associations despite absence of federal regulation).

The decisions permitting the application of harmonious state regulation to federal associations have done so not only where there was no Board regulation on point but also involved matters on the periphery of federal regulation. *E.g., Durnin* v. *Allentown Fed. Sav. & Loan Ass'n*, 218 F. Supp. 716, 720-721 (E.D. Pa. 1963) (depositor has right under state law to association's membership list where federal regulations are silent on issue); *First Fed. Sav. & Loan Ass'n of Atlanta* v. *Norwood Realty Co.*, 212 Ga.524, 93 S.E. 2d 763 (1956) (Georgia usury laws applicable to association in the absence of Board regulation on point); *Pearson* v. *First Fed. Sav. & Loan Ass'n*, 149 So. 2d 891, 895 (1963) (although Board regulations preempt the field of internal management of an association, harmonious state law may be applied to invalidate illegally obtained proxies for the election of an association's directors).

broad question is not properly presented in this case in view of the actual conflict between the regulations and state law on the very lending practice in question.[7] The decisions of the lower courts, including the decision in this case, have uniformly concluded that state law must yield to a specific Board regulation.[8] Given the limited scope of the holding below, which affects only the years 1968 to 1972, the present case is not sufficiently important to call for plenary review.

For the foregoing reasons, we respectfully suggest that the petition be granted, the judgment of the Supreme Court of Oregon be vacated, and the case be remanded for consideration of 12 C.F.R. 541.5, 544.1, and 545.1-

[7]We therefore do not discuss whether the Board's regulations have "occupied the field" with respect to the payment of interest on accounts.

[8]*E.g., Meyers* v. *Beverly Hills Fed. Sav. & Loan Ass'n*, 499 F. 2d 1145, 1146-1147 n.6 (9th Cir. 1974) (Board regulation permitting prepayment penalties prevailed over California law restricting them); *Greenwald* v. *First Fed. Sav. & Loan Ass'n of Boston*, 446 F. Supp. 620, 623-624 (D. Mass. 1978), appeal pending, No. 78-1155 (1st Cir. 1978) (Massachusetts statute requiring interest to be paid on tax and insurance escrow invalid before and after 12 C.F.R. 5456-11(c)).

The *amici* states take issue with these decisions and, thus, with the holding of the Supreme Court of Oregon that 12 C.F.R. 545.6-11(c) preempts state law on all loans made after June 16, 1975. But the parties do not contest the court's decision on this point, and respondent, which was adversely affected by this aspect of the court's decision, has not filed a cross-petition for certiorari. The contention that explicit regulations of the Board do not preempt state law therefore is not presented by this case. See this Court's Rule 15(1)(c); *FEA* v. *Algonquin SNG, Inc.*, 426 U.S. 548, 560 n.11 (1976). If the Court should grant review, respondent could raise this extreme anti-preemption argument in support of its judgment concerning 1968 to 1972 loans (see *United States* v. *New York Telephone Co.*, 434 U.S. 159, 166 n.8 (1977)), but the fact that the Court could consider the argument in this roundabout way does not offer a reason to grant the petition for certiorari, which is addressed to quite a different issue.

1(g). If the Court concludes that a remand is inappropriate, it should deny the petition.

WADE H. MCCREE, JR.
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